

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1924.

No. 80

THE UNITED STATES OF AMERICA, PETITIONER

vs.

EDWARD H. CHILDS, TRUSTEE IN BANKRUPTCY OF
J. MENIST COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE SECOND CIRCUIT

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STATEMENT OF THE COURT

(Before the Court)

No. 10

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1 United States District Court, Southern District of New York

In the matter of In bankruptcy No. 27602
J. MENIST Co., INC., Bankrupt

Order to show cause

Upon reading and filing the annexed petition of Edwards H. Childs, duly verified, and upon all the pleadings and proceedings herein it is

ORDERED, That the collector of internal revenue for the second district of New York show cause before me at my office, No. 299 Broadway, borough of Manhattan, city of New York, on the 27th day of July, 1922, at 1.15 o'clock in the afternoon, or as soon thereafter as counsel can be heard, why an order should not be granted herein directing that the proof of claim filed by the collector of internal revenue in the sum of \$2,421.75 with interest at the rate of 1% per month from the 1st day of March, 1920, until paid, be liquidated and reduced to the sum of \$2,421.75.

2 - Let service of a copy of the annexed petition and order to show cause upon the collector of internal revenue, second district of New York, on or before the 20th day of July, 1922, be sufficient.

Dated, New York, June 29th, 1922.

J. J. TOWNSEND,
Referee in Bankruptcy.

United States District Court

[Title omitted.]

Petition

To Hon. JOHN J. TOWNSEND,
Referee in Bankruptcy.

The petition of Edwards H. Childs, respectfully shows:

1. Your petitioner is the trustee herein, duly qualified and acting.
2. A proof of claim has been duly filed by the collector of internal revenue in the sum of \$2,421.75, additional income tax
3 due for the year 1917 and interest at the rate of 1% per month from the 1st day of March, 1920, until the date of payment.

3. Your petitioner believes that the said collector of internal revenue is not entitled to any interest upon said indebtedness and therefore asks for an order to show cause why the proof of claim filed by the collector of internal revenue should not be liquidated and reduced to the sum of \$2,421.75.

Dated, New York, June 28, 1922.

EDWARDS H. CHILDS, *Petitioner.*

[Jurat showing the foregoing was duly sworn to by Edwards H. Childs. Omitted in printing.]

In United States District Court

[Title omitted.]

Proof of claim

At the customhouse, in said district on the 4th day of May, A. D. 1921, came William H. Edwards as collector of internal revenue for the second district of New York, in the county of New York, in the district aforesaid, and made oath and says that the persons by (or against) whom petition for adjudication of bankruptcy has been filed was at and before the filing of said petition and still is justly and truly indebted to said deponent in the sum of \$2,421.75 dollars with 5% penalty and 1% interest per month thereon until paid; that the consideration of said debt is additional income tax for year 1917 (list Sept., 1919, fol. 18, line 6), due the United States Government; that preference is claimed on the ground that claim herein is due the United States Government; that no part of said debt has been paid; that there are no set-offs or counterclaims to the same; and that neither the deponent nor his successors, nor has any person by his order, or to his knowledge or belief, for his use, had or received any manner of security for said debt whatever; that

5 said debt is one existing in open account and was due on the 10th day of March, 1920, and no note has been received for such account, nor any judgment rendered thereon.

(Signed) W. H. EDWARDS,
Collector of Internal Revenue,
Second District of New York.

Sworn to before me this 4th day of May, 1921.

(Seal)

(Signed) ARTHUR I. PERRY,
Notary Public, New York County.
County Clerk, No. 56, Register No. 2012.

Commission expires March 30, 1922.

[Title omitted.]

In United States District Court

Hearing before referee on order to show cause

Before Hon. JOHN J. TOWNSEND, referee.

Claim of collector of internal revenue

NEW YORK, July 27, 1922, at 1.15 p. m.

Present:

Mr. Fichandler for trustee.

J. T. Dortch, solicitor's office, Bureau of Internal Revenue.

Victor House, assistant U. S. district attorney.

6. The REFEREE. This is an order to show cause against the Bureau of Internal Revenue.

Mr. Fichandler files order to show cause. In this case the petition was filed in March of 1920. I have before me the order to show cause filed with the referee to-day. I have the claim by Collector of Internal Revenue Edwards, verified May 4, 1921.

It is stipulated that the Government for the year's income of 1917 assessed an additional tax of \$2,421.75 against the bankrupt corporation on November 28th, 1919, payable by the bankrupt corporation on December 11th, 1919.

It is further stipulated that the petition in bankruptcy was filed against the taxed corporation March 20, 1920, a period of three months and 11 days after December 11th, 1919.

The Government, under section 57-J of the bankruptcy act, waives claim for the 5% penalty imposed on the \$2,421.75, pursuant to revenue act of 1917.

The question for determination by the referee as a matter of law is whether or not the Government is entitled to one per cent on \$2,421.75, pursuant to section 9-A of the revenue act of 1916, which by section 212 of the revenue act of 1917 is incorporated in the revenue act of 1917.

The question is whether I will allow one per cent interest after the date of the filing of the petition in bankruptcy on March 20th, 1920. Is not that so?

Mr. HOUSE. Yes, sir.

The REFEREE. Mr. Fichandler claims that it is not allowable.

Mr. FICHANDLER. It is not allowable after the date of the filing of the petition in bankruptcy.

The REFEREE. What is your authority?

7 Mr. FICHANDLER. Because there is no authority at all that gives preference to the Government. May I file a memorandum?

The REFEREE. Yes.

Mr. HOUSE. May I also file a memorandum?

The REFEREE. Yes. If there is nothing further, I will declare this hearing closed.

(Proceedings closed.)

In United States District Court

Opinion of referee

[Title omitted.]

On May 5, 1921, the United States by William H. Edwards, collector of internal revenue, second district, New York, filed a claim, as above stated, at \$2,421.75, plus 5 % penalty and 1 % interest per month thereon until paid.

8 On July 29, 1922, the trustee obtained from the referee an order to show cause why the claim should not be liquidated and reduced to the sum of \$2,421.75 and such order to show cause was filed with the referee July 27, 1922.

The pertinent statutes are section 14-a of Title I, Part I of the revenue act of September 8, 1916, and section 57-j of the bankruptcy act.

The language of such section 14-a is, in part, as follows: "and to any sum or sums due and unpaid after the fifteenth day of June in any year * * * there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month * * *."

Section 57-j of the bankruptcy act reads as follows:

"Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

Taxes are regarded as a debt by the bankruptcy act:

In *re* Sherwoods, Inc., C. C. A. 2d Circuit, 31 A. B. R. 769, 772, foot page 773; 210 Fed. *Rep.* 754.

9 Attention is called to the provisions of section 212 of the war revenue act of October 3, 1917, extending and making applicable the provisions of the revenue act of 1916, and in particular to the language of section 212, viz: "and all provisions of Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, relating to returns and payment of tax therein imposed, *including penalties*, are hereby made applicable to the tax imposed by this title."

The above italics are mine.

The importance of the italicised words is in their characterization of the provisions of section 14-a of the revenue law of 1916, under the provisions of which the United States Government makes its claim for the tax at \$2,421.75 with "5% penalty and 1% interest per month thereon until paid."

The Government withdraws its claim for the expressed penalty of five per centum, but maintains its claim for the one per cent per month as interest and not as penalty.

No question as to the proper assessment of the income tax arises for determination by me under §64-a: In *re* Anderson, 48 A. B. R. 350.

Notwithstanding the decision of the Circuit Court of Appeals, 4th Circuit, in *U. S. vs. Guest*, 143 Fed. *Rep.* 456, I am of the opinion that the provisions of section 212 above mentioned constitute a statutory characterization or definition of the provisions of section 14-a above mentioned as being penal, both in respect to the five per cent penalty as well as in respect to the one per cent interest per month.

Accordingly, I am of the opinion that section 57-j of the bankruptcy act (in which the sovereign is named) relieves the estate in bankruptcy, or rather its creditors, from the punitive provisions of section 14-a of the revenue law above mentioned and the drastic rate of interest prescribed.

This conclusion will find support in the decision of the District court of Massachusetts rendered upon a kindred statute: See *In re Ashland Emory & Corundum Co.*, 36 A. B. R. 194; 229 Fed. Rep. 829, to which decision the following cases are contra:

In re Kallak, 17 A. B. R. 415; 147 Fed. Rep. 276;

In re G. L. Schuyler & Co., 21 A. B. R. 428;

In re Scheidt Bros., 23 A. B. R. 778; 177 Fed. Rep. 599;

Ramirez-Quinones, 39 A. B. R., 320, 323.

The trustee is entitled to an order, within section 57-j of the bankruptcy act, allowing the claimed filed by the collector of internal revenue on May 5, 1921, at \$2,421.75, with interest at six per cent per annum to the date of payment.

New York, October 3, 1922.

J. J. TOWNSEND,

Referee in Bankruptcy.

11

11

In United States District Court

[Title omitted.]

Order allowing claim

Upon the proof of claim heretofore filed herein by the United States of America on May 5, 1921, for \$2,421.75, with interest at the rate of 1% per month from March 10, 1920, to date of payment; the objection thereto of Edward H. Childs, trustee of the above named bankrupt, verified June 28, 1922, and the order to show cause herein dated June 29, 1922, and hearing and due deliberation having been thereupon had, it is

On motion of Zalkin & Cohen, Esqs., attorneys for the trustee,

ORDERED that the claim heretofore filed by the United States of America as aforesaid, be allowed in the sum of \$2,421.75 with interest thereon at the rate of 6% per annum from March 10, 1920, to date of payment.

Dated, New York, October 27, 1922.

J. J. TOWNSEND,

Referee in Bankruptcy.

12

In United States District Court

[Title omitted.]

Petition of United States of America to review

TO JOHN J. TOWNSEND, Esq.,

Referee in Bankruptcy.

The petition of Victor House, assistant United States attorney for the Southern District of New York, respectfully alleges:

That the United States of America is a creditor of J. Menist Co., Inc., the above-named bankrupt, and that its claim has been allowed herein.

That on the 27th day of October, 1922, an order, of which a copy is hereto annexed, was duly made and entered herein.

That such order is erroneous in that the same is contrary to the evidence, the weight of the evidence, and contrary to law.

Wherefore, your petitioner respectfully asks that the said order may be reviewed, as provided in the bankruptcy law of 1898 and General Order XXVII.

Dated, New York, October 27, 1922.

VICTOR HOUSE, *Petitioner.*

13 [Jurat showing the foregoing was duly sworn to by Victor House. Omitted in printing.]

14 United States District Court

[Title omitted.]

Petition of trustee to review

To the Honorable JOHN J. TOWNSEND,
Referee in Bankruptcy.

Your petitioner respectfully shows:

1. That he is trustee in bankruptcy of the above-named bankrupt.
2. That on the 27th day of October, 1922, an order, a copy of which is hereto annexed, was made and entered herein. That such order was and is erroneous in that the United States Government of America, is not entitled to any interest on the tax assessed in the sum of \$2,421.75 pursuant to section 57-J of the bankruptcy act.

Wherefore, your petitioner, feeling aggrieved, because of such order, prays that the same may be reviewed as provided in the bankruptcy act of 1898 in General Order XXVII.

Dated, N. Y., October 30, 1922.

EDWARD H. CHILDS, *Petitioner.*

15 United States District Court

[Title omitted.]

Referee's certificate

To the Honorable Judges of the District Court of the United States for the Southern District of New York.

I, John J. Townsend, referee in charge of this case, do hereby certify that in the course of the proceedings had before me herein, the following question arose pertinent to the proceedings:

On May 5, 1921, the United States, by William H. Edwards, collector of internal revenue, second district, New York, filed a claim for \$2,421.75 for additional income tax for year 1917 with 5% penalty and 1% interest per month.

On July 29, 1922, the trustee obtained from the referee an order to show cause why the claim should not be liquidated and reduced to the sum of \$2,421.75, and such order to show cause was filed with the referee July 27, 1922.

Proceedings were thereupon had before me as shown by the accompanying stenographer's minutes, at which hearing the Government under §57-J of the act waived the claim for 5% penalty imposed on the \$2,421.75 pursuant to the revenue act of 1917.

After consideration of the evidence, the referee filed his memorandum, dated October 3, 1922, allowing the claim of the United States at \$2,421.75, with interest at 6% per annum to the date of payment; and on October 27, 1922, filed an order to that effect.

On October 27, 1922, the United States feeling aggrieved at my order made on October 27, 1922, filed with me a petition for review, which was granted.

On October 30, 1922, the trustee feeling aggrieved at my order of October 27, 1922, filed with me his petition for review, which was granted.

The question presented on this review is whether the referee was correct in allowing the claim of the United States at \$2,421.75 with interest at 6% to the date of payment.

I hand up herewith for the information of the judges, the following papers:

- (1) Proof of claim of United States filed May 5, 1922.
 - (2) Petition and order to show cause for reexamination filed July 27, 1922.
 - (3) Stenographer's minutes pages 1-3.
 - (4) Memorandum of referee, filed October 3, 1922.
 - (5) Order allowing claim filed October 27, 1922.
 - (6) Petition for review of United States, filed October 27, 1922.
 - (7) Petition for review of trustee, filed October 30, 1922.
- New York, November 4, 1922.

J. J. TOWNSEND,
Referee in Bankruptcy.

17

In United States District Court

[Title omitted.]

Notice of hearing on petition for review

SIR: Please take notice that upon the certificate of review of Honorable John J. Townsend, referee in bankruptcy, duly filed in the office of the clerk of this court on the 6th day of November, 1922, and upon all the proceedings heretofore had herein, the undersigned will move this court, at a term for motions, in room 235 of the Old Post Office Building, located at Park Row and Broadway, in the borough of Manhattan, city of New York, on the 15th day of

November, 1922, at 10.30 o'clock in the forenoon of that day, or as soon thereafter as counsel can be heard, for an order vacating and setting aside the order entered on October 27th, 1922, allowing the claim of the United States of America at \$2,421.75 with interest at 6% per annum to date of payment, and for an order directing the claim of United States of America to be allowed in the sum of \$2,421.75 without any interest, and for such other, further, and different relief as to this court may seem just and proper in the premises.

Dated, New York, November 9th, 1922.

Yours, etc.,

ZALKIN & COHEN,

Attorneys for,

No. 49 Chambers Street,

Borough of Manhattan, New York City.

To: WILLIAM HAYWARD, Esq.,

United States District Attorney,

Old Post Office Building,

Park Row and Broadway,

Borough of Manhattan, New York City.

19

In United States District Court

[Title omitted.]

Opinion

WILLIAM HAYWARD, United States attorney, for the collector of internal revenue; Victor House, assistant U. S. attorney, counsel. Zalkin & Cohen, solicitors for trustee in bankruptcy.

AUGUSTUS N. HAND, District Judge:

This is a proceeding based upon a certificate of review of the referee in bankruptcy, who decided that the Government's claim of \$2,421.75 for additional income taxes for the year 1917, with one per cent per month interest, should be allowed with interest at only the rate of six per cent per year. The Government had originally made a claim to five per cent penalty, but withdrew that at the hearing before the referee.

20 The provision of law in question is section 14-a of the revenue act of 1916 made applicable to the assessment and collection of internal revenue taxes for the year 1917 by section 212 of the revenue act of 1917. Section 14-a provides:

"* * * to any sum or sums due and unpaid after the fifteenth day of June of any year, or after one hundred and five days from the date from which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the Collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due."

Section 57-j of the bankruptcy act provides that:

"Debts owing to the United States, a State, a country, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

The involuntary petition in bankruptcy was filed during the month of March, 1920.

While the tax is not provable debt in such a sense as to render the United States a creditor entitled to vote for the election of a trustee,

21 it would seem reasonably clear that section 57-j of the bankruptcy act applies to tax penalties. It can hardly be thought that there was not an intention to include such penalties under

this section when they are such an obvious and numerous class of penal obligations. In the case of *In re Kallak*, 147 Fed. 276, and *In re Scheidt Bros.*, 177 Fed. 599, two District Courts have held that penalties provided for by State statutes ought to be paid in full as though no bankruptcy had intervened. In the first case, section 57-j of the bankruptcy act was not referred to, and in the second case the court held that under the law of Ohio a penalty of five per cent, which had accrued prior to the filing of the petition under the law of the State of Ohio, took the place of interest and was intended to cover interest till the delinquent taxes were put into judgment. The Circuit Court of Appeals for the Eighth Circuit reached the same conclusion in *Stanard vs. Dayton*, 220 Fed. 441; but the Supreme Court, in the case of *Swartz vs. Hammer*, 194 U. S., at page 444, seems to have affirmed a decree of the United States District Court for the Eastern District of Missouri, which disapproved penalties upon delinquent taxes that had been ordered paid by a referee in bankruptcy. Apparently, the rejection of the penalties was not raised by exceptions in the Appellate Courts, but the disposition of the district judge was affirmed in the Supreme Court without adverse criticism, although the disallowance of the penalties by the district judge was expressly referred to in the opinion.

In the case of *In re Ashland, Emery Corundum & Co.*, 229 Fed. 829, Judge Horton held that a New Jersey franchise tax which
22 under the New Jersey law bore interest at one per cent per month until paid should be liquidated by the bankruptcy court at the face of the tax plus six per cent per year, on the ground that one per cent a month constituted a penalty.

The Circuit Court of Appeals for the Fourth Circuit in the case of *United States vs. Guest*, 143 Fed. 456, held that under U. S. Rev. Stat., § 3184, providing for the collection of delinquent internal revenue taxes with a penalty of five per cent thereon and interest at the rate of one per cent a month, the five per cent was a penalty but the one per cent a month was not, and that one per cent a month

could be recovered but not the five per cent where the statute of limitations had run upon actions to collect penalties.

If it be true, as I believe, that section 57-j of the bankruptcy act applies to a case of this kind, the question is whether the provision as to one per cent a month can be regarded as a penalty.

That it is called interest in the statute would certainly not be conclusive upon bankruptcy courts if a State statute were involved. See *In re Ashland, Emery, Corundum & Co.*, supra (at page 831); *New Jersey vs. Anderson*, 203 U. S. 483.

While the situation may be different where clauses of two separate acts of Congress are to be harmonized when Congress used the word "interest" in providing by section 14-a of the revenue act what should be imposed for failing to pay income taxes, I can hardly suppose that it intended to exclude the interest clause of one per cent per month from the provisions of section 57-j of the bankruptcy act. I believe the word "interest" used in section 14-a was a natural one to describe a sum to be added to delinquent taxes at the rate of 23 one per cent per month. I do not regard it as a term intended to distinguish between penal and other provisions of the act.

Judge Morton in the case of *In re Ashland, Emery & Corundum Co.*, supra, quoted from the opinion of Mr. Justice White in *Sun Printing Ass'n vs. Moore*, 183 U. S. 672, and held that where there is an excessive disproportion between the sum due and the possible damages resulting from a breach, the question of disproportion is an element entering into the consideration of whether the parties intended to fix the damages or to stipulate the payment of an arbitrary sum as a penalty. Judge Morton held that one per cent a month plainly exceeded what was fairly required to make good loss to the State from delay in payment of taxes, and consequently constituted a penalty imposed for failure to pay promptly. He accordingly allowed in that case only six per cent, which was the rate of interest for individuals established by statute in New Jersey, the State where the taxes were due. This rate of interest is probably more common than any other within the United States, and it is to be noted that under section 6407, United States Compiled Statutes, if a plaintiff secures a judgment against the United States and the Secretary of the Treasury asserts a set-off, any balance found to be payable by the United States over and above the lawful set-off bears interest at six per cent.

The referee in bankruptcy held, as did Judge Morton, that six per cent was a fair measure of damages for the failure to pay taxes, and such a disposition of the case seems to me so reasonable that the order is affirmed.

December 5, 1922.

A. N. H., D. J.

24

In United States District Court

[Title omitted.]

Order of District Court affirming referee's order

A motion having duly come on to be heard to review the order of Honorable John J. Townsend, dated October 27th, 1922, allowing the claim of the United States of America in the sum of \$2,421.75, with interest thereon at the rate of 6% per annum from March 10th, 1920, to date of payment.

Now, upon reading the proof of claim of the United States of America filed May 5th, 1922, the petition and order to show cause for reexamination filed July 27th, 1922, the stenographer's minutes taken before the referee, the memorandum of the referee filed October 3rd, 1922, the order allowing the claim, filed October 27th, 1922, the petition for review of the United States of America, filed October 27th, 1922, the petition for review of the trustee, filed October 3rd, 1922, the referee's certificate of review filed November 25 6th, 1922, and the notice of motion to review the said referee's order with proof of service thereof upon William Hayward, the United States attorney for the Southern District of New York, and after hearing Vincent T. Follmar, Esquire, on behalf of the trustee and Victor House, Esquire, of counsel, on behalf of the United States of America, and after due deliberation having been had, and upon filing the opinion of the court, it is

ORDERED that the petition to review, filed by the trustee in bankruptcy herein, and the United States of America be and hereby are dismissed; and it is further

ORDERED that the order entered in the office of Honorable John J. Townsend, referee in bankruptcy, allowing the claim of the United States of America in the sum of \$2,421.75, with interest thereon at the rate of six per cent (6%) per annum from March 10th, 1920, to date of payment, be and hereby is in all respects affirmed.

Dated, N. Y., December 21, 1922.

AUGUSTUS N. HAND, U. S. D. J.

26

In United States Circuit Court of Appeals

[Title omitted.]

Petition to United States Court of Appeals to revise

To the Honorable the Judges of the United States Circuit Court of Appeals for the Second Circuit:

The petition of the United States of America, a corporation sovereign, and Frank K. Bowers, collector of internal revenue for the second district of New York, respectfully shows to this court:

That on the 5th day of May, 1921, the collector of internal revenue for the second district of New York filed proof of claim on behalf of the United States of America herein with Honorable John

J. Townsend, referee in bankruptcy, for additional income tax for the year 1917 in the sum of \$2,421.75, with 5% penalty and interest at the rate of 1% per month from March 10, 1920, to date of payment.

27 That thereafter said claimant duly waived claim to the penalty of 5% hereinabove mentioned.

That on June 28, 1922, Edward H. Childs, Esq., the trustee herein, filed a petition with said referee, and that on June 29, 1922, an order was signed thereon by said referee directing the collector of internal revenue for the second district of New York to show cause why the claim above mentioned should not be liquidated and reduced to the sum of \$2,421.75 without interest. That William Hayward, Esq., United States attorney for the Southern District of New York, duly appeared on behalf of the United States of America and said collector of internal revenue in opposition to said order to show cause; that a hearing was thereupon duly had upon said order to show cause, and that said referee thereafter on October 3, 1922, duly filed a memorandum setting forth his opinion in respect to said claim and the allowance of interest thereon. That thereafter on October 27, 1922, said referee duly made an order directing that the aforesaid claim of the United States of America be allowed in the sum of \$2,421.75, with interest thereon at the rate of 6% per annum from March 10, 1920, to date of payment.

That on October 27, 1922, a petition was duly filed herein with said referee by Victor House, assistant United States attorney for the Southern District of New York, on behalf of the United States of America, asking for a review of said order of said referee as provided for in the bankruptcy law of 1898 and General Order XXVII, by the United States District Court for the Southern District of New York, upon the ground that said order was erroneous in that the same was contrary to the evidence, the weight of the evidence, and contrary to law.

28 That on October 30, 1922, said Edward H. Childs, the trustee in bankruptcy herein, duly filed his petition for a review of said order of Referee John J. Townsend, dated October 27, 1922, pursuant to the bankruptcy act of 1898 and General Order XXVII, upon the ground that said order was erroneous in that said United States of America was not entitled to any interest upon its claim in the sum of \$2,421.75.

That thereupon on November 6, 1922, said referee duly filed herein his certificate of review and the papers upon which the same was made.

That thereafter on November 9, 1922, Zalkin & Cohen, Esqs., solicitors for the trustee herein, duly filed their notice of motion herein in the United States District Court for the Southern District of New York for an order vacating and setting aside said order of Referee John J. Townsend entered on October 27, 1922, and directing said claim to be allowed in the sum of \$2,421.75, without any interest.

That thereafter a hearing was duly had before Honorable Augustus N. Hand, United States district judge for the Southern District of New York, on said proof of claim of the United States of America, the petition and order to show cause filed by the trustee herein for the liquidation and reduction of said claim to the sum of \$2,421.75 without interest, and on all the papers filed and proceedings had herein.

That on December 5, 1922, said Honorable Augustus N. Hand, as such United States district judge, filed his opinion herein, and that on December 21, 1922, an order was made and entered herein in the United States District Court for the Southern District of New York, dismissing said petitions to review said order of Honorable John J. Townsend, referee in bankruptcy herein, and in all respects affirming the order of said Honorable John J. Townsend, referee in bankruptcy, allowing the claim of the United States of America in the sum of \$2,421.75 with interest thereon at the rate of 6% per annum from March 10, 1920, to date of payment.

Your petitioners further aver that the said order or judgment or decree of the said District Court made and entered herein on December 21, 1922, was and is erroneous in matters of law in that the said District Court committed the following errors:

First. That the United States District Court for the Southern District of New York erred in dismissing the claimant's petition for review of the order made by Honorable John J. Townsend, referee in bankruptcy, on October 27, 1922.

Second. That the said court in its order affirming the order of said Honorable John J. Townsend, referee in bankruptcy, dated October 27, 1922, and the opinion upon which the said order was based, erred in allowing the claim of the United States of America herein in the sum of \$2,421.75, with interest thereon at the rate of 6% per annum from March 10, 1920, to date of payment, in so far as said order and the opinion upon which said order was based failed to allow interest upon said claim of said United States of America at the rate of 1% per month for the period specified.

Third. That the said court in its order affirming said order of said referee and in its opinion upon which the said order was based, erred in so far as said order and said opinion found and decided that the United States of America was entitled to interest upon its claim herein for \$2,421.75 at the rate of 6% per annum from March 10, 1920, to date of payment, instead of interest at the rate of 1% per month for said period.

Fourth. That the said court in its said order affirming said order of said referee and in the opinion upon which its said order was based, erred in failing to allow the claim heretofore filed by the United States of America in the sum of \$2,421.75, with interest thereon at the rate of 1% per month from March 10, 1920, to date of payment.

Wherefore, your petitioners feeling aggrieved because of said order or judgment or decree pray that the same may be revised in matter

of law by your honorable court as provided in paragraph 24-b of the bankruptcy act of 1898 and the rules and practice in such case made and provided.

UNITED STATES OF AMERICA
AND FRANK K. BOWERS,
Collector of Internal Revenue,
By WILLIAM HAYWARD,
United States Attorney
for the Southern District of New York.

31 [Jurat showing the foregoing was duly sworn to by Victor House omitted in printing.]

32 In United States District Court
[Title omitted.]

Petition for and order allowing appeal

To the Honorable the Judges of the United States District Court for the Southern District of New York:

The United States of America and Frank K. Bowers, collector of internal revenue for the second district of New York, feeling aggrieved by the order and decree of the United States District Court for the Southern District of New York, made by the Honorable Augustus N. Hand, one of the judges thereof, and entered herein on the 21st day of December, 1922, in the above-entitled proceeding, affirming an order of John J. Townsend, Esq., referee in bankruptcy, dated October 27, 1922, allowing the claim of the United States of America herein in the sum of \$2,421.75, but limiting the recovery of interest upon said claim to the rate of 6% per annum from March 10, 1920, to date of payment, instead of allowing the recovery of such interest at the rate of 1% per month for said period, do hereby petition for an appeal upon the said order and decree to the United States Circuit Court of Appeals for the Second Circuit, to do and receive what may appertain to justice to be done in the premises, and that a transcript of the record, proceedings, and evidence in said proceeding duly authenticated, may be transmitted to the United States Circuit Court of Appeals for the Second Circuit.

Date, New York, December 30, 1922.

UNITED STATES OF AMERICA
and FRANK K. BOWERS,
Collector of Internal Revenue
for the Second District of New York.
By WILLIAM HAYWARD,
United States Attorney for the
Southern District of New York,

The foregoing appeal is hereby allowed.

Dated, New York, December 30, 1922.

J. W. MACK, U. S. D. J.

34

In United States District Court

[Title omitted.]

Notice of appeal

SIRS: Please take notice that the United States of America and Frank K. Bowers, collector of internal revenue for the second district of New York, hereby appeal from the order and decree of the United States District Court for the Southern District of New York made by Honorable Augustus N. Hand, one of the judges thereof, and entered herein on the 21st day of December, 1922, affirming an order of John J. Townsend, Esq., referee in bankruptcy, dated October 27, 1922, whereby the United States of America is allowed interest upon its claim herein for additional taxes for the year 1917, amounting to \$2,421.75 at the rate of six per cent per annum from March 20, 1920, to date of payment, instead of at the rate of one per cent per month for said period, to the Circuit Court of Appeals for the Second Circuit, to be held in and for said circuit at the United States Courts and Post Office Building, in the borough of Manhattan, city of New York.

35

Dated, New York, December 30, 1922.

Yours, etc.,

WILLIAM HAYWARD,
*United States Attorney for the
Southern District of New York,
Attorney for United States of
America and Frank K. Bowers,
Collector of Internal Revenue
for the Second District of New York,
Office & Post Office Address, U. S.
Courts & Post Office Building,
Borough of Manhattan, City of New York.*

TO ZALKIN & COHEN, Esqs.,
*Attorneys for Trustee in Bankruptcy,
49 Chambers Street, New York City.*

ALEXANDER GILCHRIST, Jr., Esq.,
*Clerk of the U. S. District Court,
Southern District of New York.*

36

In United States District Court

[Title omitted.]

Assignment of errors

Now come the United States of America and Frank K. Bowers, collector of internal revenue for the second district of New York, and file the following assignment of errors:

First. That the United States District Court for the Southern District of New York erred in dismissing the claimant's petition for review of the order made by Honorable John J. Townsend, referee in bankruptcy, on October 27, 1922.

Second. That the said court in its order affirming the order of said Honorable John J. Townsend, referee in bankruptcy, dated October 27, 1922, and the opinion upon which the said order was based, erred in allowing the claim of the United States of America herein in the sum of \$2,421.75, with interest thereon at the rate of 6% per annum from March 10, 1920, to date of payment, in so far as said order and the opinion upon which said order was based failed to allow interest upon said claim of said United States of America, at the rate of 1% per month for the period specified.

37 Third. That the said court in its order affirming said order of said referee and in its opinion upon which the said order was based, erred in so far as said order and said opinion found and decided that the United States of America was entitled to interest upon its claim herein for \$2,421.75 at the rate of 6% per annum from March 10, 1920, to date of payment, instead of interest at the rate of 1% per month for said period.

Fourth. That the said court in its said order affirming said order of said referee, and in the opinion upon which its said order was based, erred in failing to allow the claim heretofore filed by the United States of America in the sum of \$2,421.75, with interest thereon at the rate of 1% per month from March 10, 1920, to date of payment.

Wherefore the United States of America prays that the said order and decree herein for the manifest errors aforesaid, and for other errors in the record and proceedings herein, may be reversed and for naught held and esteemed; and that it may be restored to all matters and things which it has lost by reason of said order and decree, and that the United States District Court for the Southern District of New York may be directed to enter an order and decree herein allowing interest upon the claim of the United States of America as filed for \$2,421.75, with interest at the rate of 1% per month from March 10, 1920, to date of payment.

Dated, New York, December 30, 1922.

WILLIAM HAYWARD,
*United States Attorney for the
Southern District of New York.*

38 [Citation in usual form omitted in printing.]

39 In United States District Court

[Title omitted.]

Stipulation re transcript of record

It is hereby stipulated and agreed that the foregoing is a true transcript of the record of the United States District Court for the

Southern District of New York in the above entitled matter, as agreed on by the parties.

Dated, New York, January 30, 1923.

WILLIAM HAYWARD,
*United States Attorney for the
Southern District of New York,
Attorney for Appellant.*

ZALKIN & COHEN,
Attorneys for Appellee.

40

In United States District Court

[Title omitted.]

Clerk's certificate.

I, Alexander Gilchrist, jr., clerk of the District Court of the United States of America for the Southern District of New York, do hereby certify that the foregoing is a correct transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

41

In testimony whereof, I have caused the seal of the said court to be hereunto affixed, at the city of New York, in the Southern District of New York, this 1st day of February, in the year of our Lord one thousand nine hundred and twenty-three and of the independence of the said United States the one hundred and forty-seventh.

[SEAL.]

ALEX. GILCHRIST, Jr., *Clerk.*

42

In United States District Court

[Title omitted.]

Stipulation re questions for determination by Circuit Court of Appeals

Whereas, on October 27th, 1922, John J. Townsend, referee in bankruptcy, duly made an order directing that the claim of United States of America filed herein in the sum of \$2,421.75 be allowed in that sum with interest thereon at the rate of six (6%) per cent per annum from March 10th, 1920, to date of payment, and

Whereas, on the 27th day of October, 1922, a petition was duly filed herein with said referee by Victor House, assistant United States attorney for the Southern District of New York, on behalf of United States of America for a review of said order, and

Whereas, on October 30th, 1922, Edwards H. Childs, trustee in bankruptcy herein, duly filed his petition for review of said order with Referee Townsend, upon the ground that said order was erroneous in that said United States of America was not entitled to any interest upon its claim, and

43

Whereas, an order was duly entered by Hon. Augustus N. Hand, United States district judge, on the 21st day of Decem-

ber, 1922, dismissing said petition to review, and in all respects affirming the order of said John J. Townsend, referee in bankruptcy, allowing the claim of United States of America in the sum of \$2,421.75 with interest thereon at the rate of six (6%) per cent. per annum from March 10th, 1920, to date of payment,

Now, therefore, it is hereby stipulated and agreed, by and between the attorneys for the trustee and the attorney for the United States of America, that the Circuit Court of Appeals for the Second Circuit may, in addition to the questions raised by the record on appeal, determine the following questions:

1. Whether the United States of America is entitled to any interest on its claim in the sum of \$2,421.75 after the adjudication in bankruptcy herein.

2. If the United States of America is entitled to interest upon its claim, whether the rate of interest is 1% a month or 6% per annum from March 10th, 1920, to date of payment.

Dated, New York, January 30th, 1923.

ZALKIN & COHEN,
Attorneys for Trustee.

WILLIAM HAYWARD,
Attorney for United States of America.

44 United States Circuit Court of Appeals for the Second Circuit

IN the matter of J. MENIST CO., INC., BANKRUPT } *Opinion*
UNITED STATES OF AMERICA, APPELLANT

Appeal from an order in bankruptcy entered in the District Court for the Southern District of New York.

The petition in this matter was filed 20th March, 1920.

On 28th November, 1919, the United States had assessed on Menist's income for 1917 an additional tax of \$2,421.75, and required the corporation to pay the same on December 11, 1919. No payment was made.

On 5th May, 1921, the United States filed a claim in this proceeding for the said tax plus five per cent penalty and one per cent interest per month until paid.

That the tax was duly levied and is correct in amount are matters not in controversy.

45 The statutory justification asserted for the demand of interest and penalties is act of October 3, 1917 (40 Stat. 300, sec. 212), making sec. 14 (a) of the act of September 8, 1916 (39 Stat. 756), applicable to taxes under the 1917 act.

By these statutes it is provided that:

"* * * to any sum or sums due and unpaid after the fifteenth day of June of any year, or after one hundred and five days from the date from which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the Collector, there shall be added the sum of five per centum on the

amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due."

At the hearing below the United States withdrew its claim for the penalty of five per centum, but insisted upon the demand for one per centum per month under the guise of lawful interest.

The lower court held that so-called interest at the rate of one per cent a month amounted to a penalty, and therefore allowed the tax with interest at six per cent to be computed to the day of the date of payment by the trustee.

There appears to be an error in the transcript as to the time when interest should begin. It has not been insisted upon in argument and may be corrected by agreement.

From the order embodying this decision the present appeal was taken.

Victor House, assistant U. S. attorney, for appellant; E. Fichandler for the trustee in bankruptcy.

46 **HOUGH, C. J.:**

The fundamental proposition thought to justify this appeal is that a tax is not a debt. This is usually true; taxes are not treated as debts, because the latter are obligations founded on contract, while taxes are imposts levied by government and operating in invitum. (*Meriwether vs. Garrett*, 102 U. S. 472, at 313-514.)

But we are here concerned only with the bankruptcy statute, and a tax whether due to the nation, to a state or any other lawful taxing power, is a species of debt under that act. This is because it is called a debt by the statutory caption of sec. 64, which is the law invoked, and properly invoked, by the Government in pursuing its present demand. (30 Stat., p. 563.) Further, this court has so decided in *re Sherwoods*, 210 Fed. 754 (758), and the point is elaborately and well treated in *Kaw, etc., vs. Schull*, 230 Fed. 587.

A tax being then a preferred debt; neither interest nor any other derivative or appended claim can rise higher than the tax debt which gives it birth and being; and it is provided in respect of all debts "owing to the United States, a state, a county, etc." as a penalty, shall not be allowed except for the amount of the pecuniary loss sustained in the proceeding out of which the penalty arose. (Sec. 57-j.)

47 It is a matter almost too plain to require citation, that an exaction may be a penalty without being called by that name. (*Fontenot vs. Accardo*, 278 Fed. 871, at 874.) The question is often one of degree, for on one would doubt that if the statutory rate for withholding a tax was one per cent a day, the requirement would be treated as a penalty.

Subject to statutory limitation, the rate of interest or, what is the same thing, compensation for the use of money, is ordinarily fixed by agreement of parties. But in tax matters there is no such agreement; one party commands and the other must obey, and again subject to constitutional limitations the commanding party may impose any terms of payment that it pleases, and it makes no difference

whether the price of delayed obedience is called interest or penalty or fine or additional tax; every increase over the amount that satisfies the tax if paid the moment it is levied, is merely an additional exercise of the power of the taxing authority.

Since in bankruptcy (and we are solely concerned with bankruptcy) the power of ascertaining the amount or legality of any tax is vested in the court (sec. 64-a) and penalties are not to be allowed except for the amount of pecuniary loss sustained by the delayed payment, the only question here is whether an exaction of one per cent a month as the price of delay amounts to a penalty. (As to nature of interest generally see *Agency, etc., Co. vs. American Co.*, 258 Fed. 363, at 372.)

On the point at bar we are in accord with *Re Ashland, etc., Co.*, 229 Fed. 829, and hold that there being no evidence of any injury or damage to the Government by the withholding of this tax except that which flows from the nonpayment of a just debt, anything in excess of the legal rate of interest is to be treated as a penalty and not allowed.

The point seems not to have been argued in *Re Kallak*, 147 Fed. 276, *In re Scheidt*, 177 Fed. 599, or *In re Quinones*, 39 A. B. R. 320; but in the implications of these cases we can not concur. As the question here arises under the bankruptcy act, *United States vs. Guest*, 143 Fed. 456, does not apply; there being no reason why a penalty, by whatever name called, may not be enforced against an individual—if properly expressed in agreement or statute.

The question remains whether a tax demand duly proved should continue to draw interest at the legal rate after the filing of petition for adjudication. The general rule is, of course, that interest stops with petition filed (*Sexton vs. Drayfuss*, 219 U. S. 339), but a tax debt due to any of the taxing authorities enumerated in sec. 64 A is not only a highly preferred debt, but the section contains specific directions that the trustee shall pay "all taxes legally due and owing." That means legally due and owing in accordance with the provisions of the bankruptcy act, and under that statute sec. 27-j requires penalties due to the United States, or a State, etc., to 49, 50 be allowed to the extent of the pecuniary loss suffered. The loss continues as much after petition filed as before.

We agree with the court below that these directions can not be fulfilled except by an order on the trustee to pay the tax with lawful interest down to the date of actual payment.

Order affirmed.

51, 52 In United States Circuit Court of Appeals

[Title omitted.]

Judgment—Filed April 26, 1923

Appeal from the District Court of the United States for the Southern District of New York.

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be, and it hereby is, affirmed.

It is further ordered that a mandate issue to the said District Court in accordance with this decree.

H. W. R.

C. M. H.

53

In United States Circuit Court of Appeals

Clerk's certificate

UNITED STATES OF AMERICA,

Southern District of New York, ss.

I, William Parkin, clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 52, inclusive, contain a true and complete transcript of the record and proceedings had in said court, in the case of—in the matter of J. Menist Company, Inc., bankrupt; United States, appellant, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said court to be hereunto affixed, at the city of New York, in the Southern District of New York, in the Second Circuit, this 16th day of May, in the year of our Lord one thousand nine hundred and twenty-three, and of the independence of the said United States the one hundred and forty-seventh.

[SEAL.]

WM. PARKIN, *Clerk.*

54

Writ of certiorari and return—Filed October 24, 1923.

UNITED STATES OF AMERICA, ss:

The President of the United States of America to the Honorable the Judges of the United States Circuit Court of Appeals for the Second Circuit, Greeting:

Being informed that there is now pending before you a suit in which the United States of America is appellant and Edward H. Childs, trustee in bankruptcy, is appellee, which suit was removed into the said Circuit Court of Appeals by virtue of an appeal from the District Court of the United States for the Southern District of New York, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be cer-

55 the Supreme Court of the United States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the

said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable William H. Taft, Chief Justice of the United States, the eleventh day of October, in the year of our Lord one thousand nine hundred and twenty-three.

WM. R. STANSBURY,

Clerk of the Supreme court of the United States.

56 (Indorsement:) File No. 29667. Supreme Court of the United States, No. 357, October Term, 1923. The United States of America vs. Edward H. Childs, trustee in bankruptcy of J. Menist Company. Writ of certiorari.

57 In the Supreme Court of the United States
October term, 1923

UNITED STATES, PETITIONER,	} No. 357.
v.	
EDWARD H. CHILDS, TRUSTEE, RESPONDENT.	

Stipulation as to return to writ of certiorari

It is hereby stipulated by counsel for the parties to the above-entitled cause that the certified copy of the transcript of the record now on file in the Supreme Court of the United States shall constitute the return of the clerk of the United States Circuit Court of Appeals for the Second Circuit to the writ of certiorari granted therein.

JAMES M. BECK,

Solicitor General.

MOSES COHEN,

Counsel for Respondent.

OCT. 15, 1923.

58 *To the Honorable the Supreme Court of the United States,*
Greeting:

The record and all proceedings whereof mention is within made, having lately been certified and filed in the office of the clerk of the Supreme Court of the United States, a copy of the stipulation of counsel is hereto annexed and certified as the return to the writ of certiorari issued herein.

Dated New York, October 18, 1923.

[SEAL.]

WM. PARKIN,

*Clerk of the United States Circuit Court
of Appeals for the Second Circuit.*

59, 60 [File indorsements omitted.]

